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# FIRST NATIONAL CITY BANK

*Monthly Letter*

**Business and Economic Conditions**

## General Business Conditions

New York, December 1961

THE reports on business in October and early November suggest that the "lull" is over and that the economy is back on an upward path. Production and trade, hampered by strikes and adverse weather in September, are probing ahead again, slowly but on a broad front. Detroit is much encouraged by the favorable initial reception of the new '62 model passenger cars and is hopeful that its sales next year will exceed 6½ million cars. If realized, this would make 1962 the second best year in the industry's history. Merchants generally have been cheered by apparent revival of consumers' willingness to spend. Government outlays continue on a rising course, though businessmen, held back by the pinch on profit margins and the abundance of present capacity, remain cautious in scheduling additions to outlays for plant and equipment.

Industrial production, as measured by the Federal Reserve index (seasonally adjusted, 1957=100), which had dipped to 111.5 in September under the influences of the General Motors strike and hurricane Carla, recovered in October to 113, the level recorded for August. Strikes incident to the negotiation of new wage contracts had held back automobile production in early October, but in November the industry was able to push production close to 650,000 cars, the highest monthly total since March 1960. Other consumer goods, nondurable as well as durable, scored gains in October and also, apparently, in November. Helped by foreign orders, production of business capital equipment set a record in October.

The flow of new orders at steel mills is picking up, as officials of steel-consuming industries ponder the possibility of another strike when the present steel wage contract expires on June 30, 1962. The steel companies report active inquiries for metal to be delivered early next year. It seems clear that the first half of 1962 will be a period of accelerated steel production as demands for inventory building are superimposed upon heavy consumption requirements. *Steel* magazine estimates that as much as 9 million tons of finished steel—nearly one fifth of all steel shipments forecast for the first half of 1962—will go to build inventories. The other aspect of the matter is that some of this first-half business will be borrowed from third quarter 1962 when, strike or no strike, a letup in steel activity would seem foreordained. There could be a way out of this distortion of the prospective 1962 business pattern, through agreement on a steel contract months ahead of termination date, but this kind of economic statesmanship has had no precedent in steel wage negotiations.

Anticipation of increased demand for steel has not yet had any visible influence on mill production. The peak output for the year to date was reached in the last week of September, equivalent to 111 million tons a year. Since then, pourings have tended to decline moderately under seasonal influences, though it now seems likely

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that total production for the year will fall only nominally short of the 99 million tons in 1960.

Industrial production has been helped by the growth of business inventories, which have been on a rising course since March on a seasonally adjusted basis, though this increase has been no more than in line with the expansion of business volume. During September (the latest month for which figures are available), business inventories rose $600 million—equivalent to a seasonally adjusted annual rate of $7.2 billion. But the ratio of stocks to sales remained even lower than at the bottom of the recession.

### *Sales Respond to Higher Incomes*

Total employment in October increased 768,000 over September—more than usual at this season—to 67,824,000, the largest number for any October. Unemployment declined seasonally to 3,934,000, the first time in a year the figure had dipped below the 4 million mark. However, October is ordinarily the low month of the year for unemployment, and a rising number out of work is generally to be expected as winter weather sets in between November and February. The seasonally adjusted rate of unemployment, which hovered around 6.8 per cent from December 1960 through October 1961, should, nevertheless, show some reduction.

Helped by a rise in factory payrolls, total personal income in October rose to a record annual rate of $425 billion, up $4 billion from September and $22 billion from the recession low in February. Seasonally adjusted employment in manufacturing, while up 390,000 since February, was 1,457,000 below the record of 17,819,000 touched back in November 1943. But rising wage levels keep adding to payroll costs. Average earnings of production workers in manufacturing reached a new high of $2.35 an hour, reflecting in part the contractual wage increase given to steel workers on October 1. The great bulk of working people are employed outside of manufacturing, with 11½ million in trade, 9 million in government, and 8 million in service occupations.

There is support for better retail volume in these higher levels of employment and personal incomes. A favorable omen appeared as deliveries of new cars to consumers in the first 20 days of November averaged 22,400 per selling day, a new high for that period. The performance was especially encouraging to the industry since stocks in dealers' hands have been lower than normal—about 31 days' supply at the current rate of sales. With today's multiplicity of makes and body styles, about 45 days' sales is generally considered an adequate supply.

Spurred by high auto sales, total retail sales in October rose 2½ per cent over September to $18.6 billion, seasonally adjusted, the first good rise since March. Retailers have high hopes for the Christmas season, with a 5 per cent gain over 1960 sales widely anticipated.

### *Moderate Rise in Capital Spending*

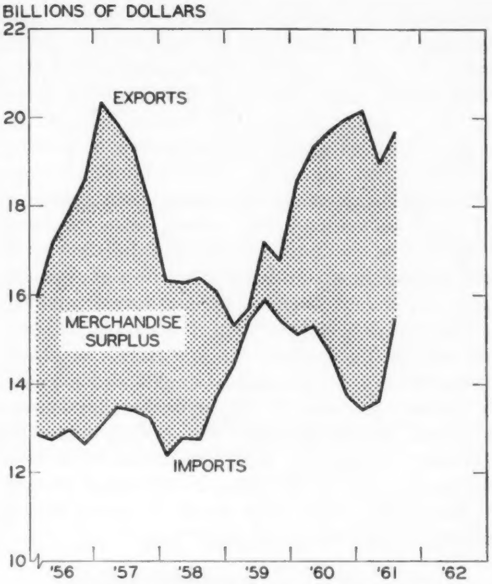
The McGraw-Hill survey of business plans for spending on new plant and equipment in 1962, conducted in October, projected a total of $35.8 billion, which would represent an increase of 4 per cent over the $34.5 billion now estimated for 1961 but a shortfall of 3 per cent from the record $37.0 billion in 1957. The lack of bounce in investment plans is attributable to continuing pressures on profit margins, sharply competitive market conditions, and the availability of unused capacity. In September 1961, according to McGraw-Hill estimates, manufacturers were operating at 81 per cent of capacity, up from 77 per cent in December 1960, but below the 94 per cent preferred for greatest efficiency.

The Kennedy Administration is actively concerned to speed economic growth on both sides of the Atlantic, and Under Secretary of State George W. Ball has proposed to the Organization for European Cooperation and Development (OECD) that this group of nations set a target of 50 per cent growth between now and 1970. It is good to have high goals if only there is the will to face the realities of what is needed to realize them. Continental European members of OECD, through the industry of their peoples and progress-oriented tax policies, have given a forceful demonstration over the past decade of the way to get ahead. The problem for the United States—and for the United Kingdom as well—is to find fiscal and wage policies that raise the horizons for private enterprise.

### *Weakening Balance of Payments*

Our foreign trade made a significant contribution toward moderating the business recession last winter. In the first quarter, commercial exports pushed up to $20.2 billion a year, while imports were depressed to a $13.6 billion annual rate, creating a trade surplus of $6.6 billion a year. The swelling of the trade surplus to this magnitude, while influenced to a degree by some special elements, including a bulge in cotton shipments, nevertheless meant increased demands for dollars in the foreign exchange markets and checked the outflow of gold.

Reductions of inventories played a role in the decline of our imports. The growth of exports




**U.S. Merchandise Exports and Imports**

(Quarterly, seasonally adjusted, at annual rates. Exports exclude shipments under military aid programs.)

reflected intensified efforts on the part of American manufacturers to sell more abroad to keep their plants busy. The success of these efforts was helped by booming business in Western Europe and Japan which enlarged our markets in those countries.

With improvement in business conditions here and associated increase in business inventories, imports have recovered. Meanwhile, with a cooling of boom conditions in Western Europe and Japan, and toughened competition, exports have slipped a little below the $20 billion-a-year rate. By the third quarter, as the chart shows, our trade surplus had narrowed to a $4.2 billion-a-year rate. Even though 1961 as a whole may produce the largest trade surplus since 1957, it evidently will be more like $5 billion than $6.6 billion.

In evaluating U.S. transactions with the rest of the world, it must be borne in mind that we would presently need a surplus on merchandise trade account of something like $6½-7 billion to realize a basically balanced international payments position. We need a surplus of this order of magnitude in order to finance the obligations the United States Government has shouldered in the interest of providing defenses against Soviet aggression and assisting underdeveloped countries. U.S. military expenditures abroad continue to run at an annual rate of $3 billion, despite continuing efforts to shift some of the burden to economically strengthened Western European nations. U.S. Government foreign economic aid —about one fourth of which is currently used for purchases outside the United States and represents, therefore, a burden on the balance of payments—is now rising after showing little net change in recent years.

The temptation often is to put the blame for balance-of-payments deficits on movements of capital from the American to foreign markets. But this is a shortsighted view. As discussed in these pages last June, remitted income on foreign investments of Americans regularly has exceeded net private long-term investments abroad. And these investments, if successful, fortify the basic balance-of-payments position for years ahead.

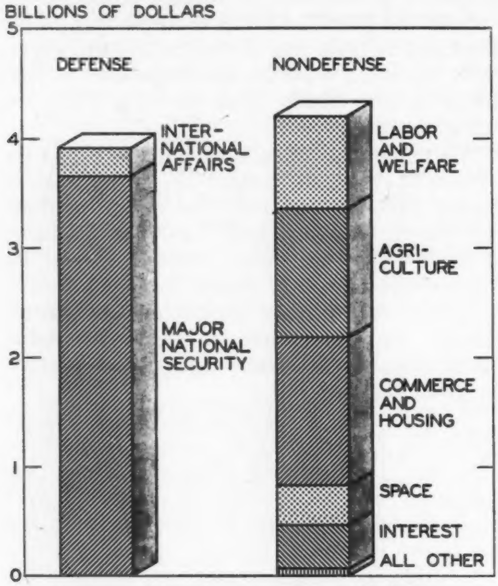
The reduction in the U.S. gold stock through November 22, adjusted to exclude transactions with the International Monetary Fund, has amounted to $941 million as compared with nearly $2 billion in 1960, $1 billion in 1959, and $2¼ billion in 1958.

It is difficult for most Americans to appreciate that we have a balance-of-payments problem unless the red light of gold outflow is blinking. The problem itself is not so dangerous as some of the expedients that might be proposed for dealing with it. We must not get sidetracked into futile efforts to escape from the reality that we live in a competitive world. Competitive power of dynamic free enterprise is the bulwark of our economic strength.

## Rise in Federal Spending

In late October, after the adjournment of Congress, the Budget Bureau released its "mid-year" budget review, bringing up to date the federal budget outlook for the current fiscal year ending June 30, 1962. While the figure for budget receipts, $82.1 billion, is essentially unchanged from the original January forecast, budget expenditures for fiscal '62 are now projected at $89 billion, highest peacetime total in history and $8.1 billion above the amount proposed in President Eisenhower's January budget. This rise in spending converts the $1.5 billion surplus planned last January into a budget deficit officially estimated at $6.9 billion, following the $3.9 billion deficit for fiscal '61.

It had been apparent ever since President Kennedy's first statement on the budget, in March, that budget expenditures would considerably exceed the January proposal of $81 billion. The figure has moved up, step by step, reflecting not only reactions to Russian successes in space and the build-up in military strength to meet




**Increases Over January Budget Estimates of Defense and Nondefense Spending Fiscal Year 1962**

Soviet threats, but also, and more fundamentally, a policy of increased government spending to create more jobs and provide more welfare benefits. As the table shows, major revisions in fiscal '62 budget estimates were announced in March, May, July, and October—each boosting projected spending and widening the gap between federal receipts and expenditures.

**Administrative Budget Estimates for Fiscal 1962**
(In Billions of Dollars)

| | Expenditures | Receipts | Surplus (+) or Deficit (−) |
|---|---|---|---|
| January budget | $80.9 | $82.3 | $+1.5 |
| March revision | 84.3 | 81.4 | −2.8 |
| May revision | 85.0 | 81.4 | −3.6 |
| July revision | 87.7 | 82.4 | −5.3 |
| October revision | 89.0 | 82.1 | −6.9 |
| Jan.-Oct. changes | +8.1 | −0.2 | −8.4 |

Note: Based on unrounded data.

While public attention recently has focused on the military side of the increased spending totals, closer inspection reveals that the greater part of the $8.1 billion increase has resulted from nondefense programs. Outlays for Major National Security are now scheduled $3.7 billion higher than in January and an increase of another $254 million is planned for International Affairs and Finance.

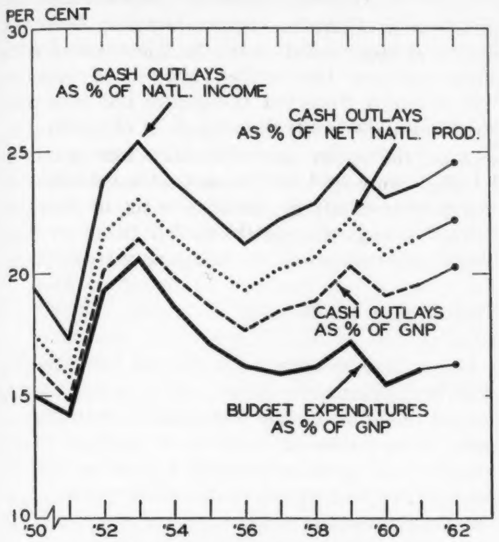
But spending for civilian programs has been raised even more—by $4.2 billion since the original '62 estimates. Projected outlays for Commerce and Housing have been boosted $1.4 billion since January as a result of new funds authorized for various housing programs and the failure of Congress to reduce the postal deficit by raising postal rates. Outlays for Space Exploration, now put at $1.3 billion for fiscal '62, have been lifted $370 million above the original estimates with the objective of putting a man on the moon by 1970. Abundant crops and higher support levels, along with subsidies for land retirement, are raising costs of farm programs, as evidenced in the $1.2 billion rise to $6.3 billion shown under the heading of Agriculture. Labor and Welfare expenditures, up $844 million to $5.6 billion, reflect a variety of new and enlarged programs, ranging from temporary extension of unemployment benefits and expanded public assistance to bigger outlays for education and health. Finally, the deficit financing necessary to pay the bills has produced a $400 million increase to $9 billion in estimated interest on the public debt, now slated to reach $295.2 billion at the end of the fiscal year.

### *Perspective on Spending Totals*

Realizing that the $89 billion expenditure figure for fiscal '62 revealed in the budget review would awaken concern as to the magnitude of federal spending, the Bureau of the Budget took some pains to view the totals against a broader economic background. The review points out:

> Although increasing in amount, federal budget expenditures since 1955 have remained a relatively stable proportion of the total output of goods and services in the nation. In fiscal year 1962, as in 1961, expenditures are estimated to be about 16% of the gross national product, less than the percentage in the fiscal years 1955 and 1959. . . .

While this approach may on the surface appear reassuring, there is serious question whether matching budget expenditures against the gross national product (GNP) is a meaningful measure of the impact of the Federal Government on the economy. Shortly after the review was published, Budget Director David E. Bell, addressing the American Institute of Certified Public Accountants, described the regular or administrative budget as "seriously incomplete" since it ignores federal trust funds and government-sponsored enterprises through which more and more of the Federal Government's money is flowing, outside the regular budget. With the passing of years, students of finance have come to center their attention on figures for the cash budget, which includes all Federal Government transactions with the public, as opposed to the narrower administrative budget. On the cash accounting basis, federal expenditures in the current fiscal year are scheduled to rise no less than $11.8 billion, to $111.1 billion, against receipts of




**Federal Spending in Perspective**

$102.8 billion for a deficit of $8.4 billion. The more inclusive accounting basis thus shows not only a much higher level of expenditures but also a considerably larger deficit.

These more comprehensive figures ought to be used in evaluating the proportion of federal expenditures in the economy. If this is done, federal spending comes out at over 20 per cent of GNP as compared with the 16 per cent figure based on the administrative budget. As the accompanying chart shows, expected fiscal '62 cash outlays as a per cent of GNP were matched in peacetime only in fiscal '59.

A further question is whether gross national product is the best base against which to measure, since it includes a sizable amount of current production which merely replaces business capital goods and housing worn out or damaged in the course of being used—outlays which merely keep our capital stock intact. With these capital consumption allowances taken out of the GNP, and *net national product* used as a base, the share of federal cash outlays for fiscal '62 becomes 22 per cent, a rate unsurpassed since 1953.

Perhaps an even more appropriate basis for measurement is national income—the amounts received by persons and businesses from which they may spend or invest, as well as pay income and social security taxes. Federal cash outlays projected for fiscal '62 are equal to almost 25 per cent of expected national income, highest since fiscal '53 during the Korean war.

The approach of federal spending to 25 per cent of national income calls to mind the proposition advanced several years ago by the distinguished statistician and student of economic growth, Colin Clark, who warned that nations which allow their tax burden to reach one quarter of national income face severe inflationary consequences as a result of governmental drains on economic resources. The forms of taxation that Mr. Clark had in mind included state and local levies as well as taxes collected by central governments; on this basis, we already are well over this "critical level of taxation beyond which inflationary forces come into play. . . ." While there may be no magic number at which inflation arises, the message is clear enough: an economy in the grip of burgeoning government spending cannot long expect stability of price levels.

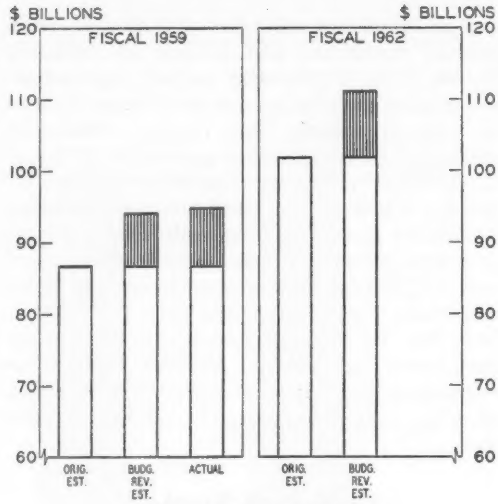
### *Repeating a Mistake?*

The steep ascent of the federal spending curve in fiscal '62, coming in the year after the recession, is disturbingly reminiscent of the 1958-59 budget experience. Reviewing this episode in a speech last year, Professor Arthur F. Burns, former chairman of the President's Council of Economic Advisers and our outstanding expert on business fluctuations, pointed out:

> The main impact of the federal spending programs that were then inaugurated came after the recession was over. The cash deficit of $13 billion occurred in the fiscal year which ended [in June 1959]—a year of continuous business expansion, not in the preceding fiscal year when the economy was depressed.

It is worth recalling that the original budget proposals for fiscal '59, submitted in January 1958, called for total cash outlays of $86.7 billion, but subsequent anti-recession measures and increases in other programs lifted this total by $8 billion to $94.8 billion when the final figures were in. With a serious overestimate of revenues, which had been expected to cover outlays, the $13 billion cash deficit materialized.

The budget proposals for fiscal '62 were framed in January 1961, likewise in the middle of a business recession, and called for total cash outlays of $101.8 billion, within the limit of prospective receipts. This time cash expenditures are up $9.3 billion from the original plan. It is true that the prospective deficit is much smaller—the recession is milder and revenues have been better sustained. On the other hand, in view of the established momentum of expansion in federal spending, and possible failure of revenues to come up to the mark, many observers are inclined to suspect that the cash deficit, when the accounts are closed for the fiscal year, may prove to be greater than the $8.4 billion now anticipated.




**Federal Cash Outlays**
(Shaded areas represent increase over original estimates.)

The aftermath of the 1958-59 experience should not be forgotten. Inflationary fever rose. The U.S. balance-of-payments deficit approached $4 billion, the worst ever, in the calendar years 1959 and 1960. A heavy outflow of gold was precipitated. The Federal Reserve, seeking to offset the inflation of government spending, put in force a restrictive credit policy which created the tightest money market we have had in a generation. The longest steel strike in our history killed off whatever vitality was left in a recovery that collapsed before it was completed. It is not unnatural that some people should be fearful of a parallel sequence of developments.

### *Rebalanced Budget for Fiscal '63?*

President Kennedy has taken action to put brakes on the rise in federal spending, particularly on the score of nondefense projects. Noting that "appropriations are only a ceiling, not a mandate to spend," on October 26 the President asked his department and agency heads to "follow a most careful and frugal policy with respect to commitments and expenditures under the 1962 budget. . . ."

The real test of the Administration's determination to accommodate defense needs while holding back spending on civilian welfare programs will come in the fiscal year beginning July 1. The broad dimensions of the fiscal '63 budget, to be submitted to Congress in January, have already been suggested in statements by the Administration. President Kennedy has declared that he intends to submit a balanced budget for the fiscal year beginning July 1, "barring extraordinary and unforeseen defense requirements." From statements made by Budget Director Bell, the apparent hope is that business will expand with such vigor that the resultant growth of revenues will not only wipe out the deficit but also provide funds for further increases in expenditures. The question asked in the business community is whether we would not be on a sounder basis for accelerated economic growth if a closer restraint were imposed on spending and some of this money were applied to easing repressive taxes.

## The Price of Bread

In our time people are far better off than the plebeians of ancient Rome, who, Juvenal said, longed only for "bread and circuses." We have more leisure time and our own chariots, four-wheeled and gasoline-propelled, with which to enjoy it. But, though less dominant in the national diet than in earlier days, bread remains one of our most important—and cheapest—foods.

As the "staff of life," bread—its supply, distribution, and price—has been a vital concern for kings and legislators. Shortages of this staple food, and increases in its price, in days past led to riots and even revolutions. Until our modern age of abundance, the price of bread was commonly regulated. In England, an act of Parliament in 1266 to regulate the price of bread was not repealed until 1815. By this act, the price of bread was set according to the prevailing price of grain. In 1600, when wheat averaged about 28 shillings a quarter (8 bushels), the "allowance" for bread baked from a quarter of wheat was set as follows:

| | Shillings | Pence |
|---|---|---|
| Fuel | | 6 |
| Two journeymen and two boys | 1 | 8 |
| Yeast | 1 | 0 |
| Candles and salt | | 4 |
| Himself, his wife, children and rent | 2 | 0 |
| Miller's toll | 1 | 4 |
| **Baker's Allowance** | 6 | 10 |

The temptation to blame the baker for increases in the price of bread has always been strong. The *Encyclopaedia Britannica* cites some historical examples:

> In Turkey the lot of the baker was hard. Baron de Tott, writing of Constantinople in the eighteenth century, says that it was usual, when bread went to famine prices, to hang a baker or two, which was promptly done. A barbarous punishment, inflicted in Turkey and in Egypt on bakers who sold light or adulterated bread, consisted in nailing the culprit by his ear to the door post of his shop.

Because of the fertility of our soils, and the hard work and ingenuity of our farmers and farm machinery builders, we have had little need to

worry about the supply or price of wheat and bread. Except in wartime, we have not attempted to use artificial controls to keep bread prices down.

### *Government Programs Raising Food Costs*

In the modern day, indeed, governments operate programs to keep up basic food prices with the interest of the producer getting priority over the interest of the consumer. The United States Government continuously since 1938 has had programs to hold up the price of wheat. Despite efforts to get farmers to reduce their plantings, and bargain sales in foreign markets, we have $2.9 billion of government money tied up in over 1.4 billion bushels of wheat, an amount which, converted into bread, would provide about 500 loaves for every man, woman, and child in the country.

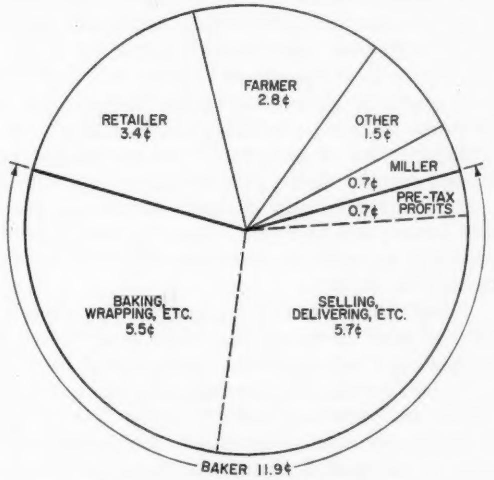
In pursuance of farm price support programs, Secretary of Agriculture Orville Freeman announced last summer that the average support for the 1962 wheat crop would be raised to $2.00 per bushel, national farm average, from $1.79 for this year's crop. As a natural response to this action, both spot and futures prices of wheat rose in the markets. No. 2 high protein hard winter wheat, a favorite bread-making type, is currently quoted in Kansas City at around $2.25 per bushel compared with $2.13 a year ago. In turn, the statutory minimum selling prices for supplies owned by the government's Commodity Credit Corporation moved up.

Wheat price advances prompted E. E. Kelley, Jr., president of the American Bakers Association, to warn last August that higher bread prices were in the offing. He pointed out that prices of bread flour had gone up by 35 to 40 cents per hundredweight over year-ago levels, and declared: "It will be little short of a miracle if bread prices are not increased in the near future throughout the nation."

This brought an immediate reply from Secretary Freeman, who maintained that "any increase in the price of wheat to the farmer will increase the farm cost of a loaf of bread only one fourth of a cent." He was critical of the fact that the average price of bread had risen from 14.3 cents a loaf (one pound) in 1950 to 20.3 cents in 1960, and charged that:

> It would appear that the Bakers Association has taken every opportunity to increase the price of bread through the past decade, while none of the loss the farmer has suffered has been passed on to the consumer in lower prices.

Secretary Freeman's statement charging the bakers with raising prices at "every opportunity" must be considered as mild compared with the examples of actions against bakers cited by *Britannica*. But it hardly seems fair to blame bakers for increases in the price of bread when it is government policy, for the benefit of farmers, to keep up the price of their products, and, for the benefit of workers, to raise wage rates. The price of bread cannot be analyzed solely in terms of the price of wheat; it must be examined in light of generally rising scales of costs for processing, transportation, packaging and–last but not least–maintaining quality of product. If we want good, full-weight loaves produced in clean modern bakeries, we must meet the costs.




**Shares of Retail Price of Bread in 1960—20.3¢ per pound**

Sources: Estimates of over-all marketing margins by U.S. Department of Agriculture; breakdown of bakers' costs by this bank's Economics Department based on industry data, adjusted to Department of Agriculture estimates.

As the accompanying diagram shows, what the housewife pays for a one-pound loaf of bread–an average of 20.3 cents last year–is not a matter of chance nor is it the result of avarice among bakers. It is, in fact, the sum of all the costs that must be met–from the planting of wheat on the plains to checking out the sale at the local supermarket–to bring forth a fresh loaf ready for the family table. While the baker's share seems to loom large, this reflects the rising expenses that must be covered in baking and distributing bread. When all costs are met, the baker gets only a thin slice–profits before income tax of about seven tenths of one cent.

There are no evidences of profiteering in the income statements of the baking companies. Quite the contrary. The January 1961 issue of the Department of Agriculture's publication, *The Marketing and Transportation Situation,*

carried a compilation of after-tax profit margins for six leading baking companies which shows a decline from the 1947-49 average of 4.1 cents per sales dollar to 2.3 cents in 1959. Later information shows that profit margins for the same six companies were trimmed to 1.9 cents per sales dollar in 1960. So far this year, all six companies have reported a further drop in earnings, and two of them show deficits for the first nine months.

The increase in government support prices for wheat came at a time when bakers were already under pressure from a profit squeeze. This squeeze hurts the industry in two principal ways. On the one hand, rising wages and distribution expenses make it imperative that bakers modernize their equipment in order to hold down their costs. At the same time, the thinness of profit margins, together with high taxes, makes it difficult for bakers to accumulate the capital needed to pay for the new equipment. A price control—or "hanging a baker or two"—can hardly have any consequence but to discourage people from entering, expanding, and improving the bread-baking business.

Should the price of bread be advanced to cover costs of ingredients and to sustain quality, this is something every realistic person should be able to understand. Government should see and acknowledge its responsibility. If this should lead to reconsideration of programs which raise the cost of living and depreciate the value of the dollar, so much the better.

## Free Market for Silver

Much has been written about the $5.8 billion decline in the U.S. gold reserve over the past four years. Meanwhile, almost unnoticed by the general public, a drain on U.S. silver stocks has set in. Even though the current decline dates back only to the summer of 1959, and has been of far smaller magnitude than in the case of gold, a practical policy question was posed for the U.S. Treasury.

The problem is being resolved in a sensible way. On November 29, at the direction of the President, the Treasury discontinued sales of silver for use in the arts and industry. To assure adequate supplies of the metal for subsidiary coinage—halves, quarters, and dimes—the President instructed the Treasury to reduce circulation of silver certificates, which tie up silver bullion as backing. He said that he would ask Congress next year to authorize the Federal Reserve Banks to issue $1 bills (practically all of which today are silver certificates) and also to repeal the Silver Purchase Acts. The program as a whole "will permit the establishment [in the United States] of a broad market for trading in silver on a current and forward basis comparable to the markets in which other commodities are traded."

In the London free market, the initial reaction was a rise from the equivalent of 93.83 cents per ounce on November 28 to 99.40 cents on the 29th. In New York, the market price advanced from 91 ⅜ cents to $1.00 ¾.

U.S. Treasury officials have had the silver problem under close study for some time and have had meetings with representatives of producers and users. On October 9 silver matters were transferred from the Bureau of the Mint to a new Office of Domestic Gold and Silver Operations under the direct supervision of Robert V. Roosa, Under Secretary of the Treasury in charge of monetary affairs.

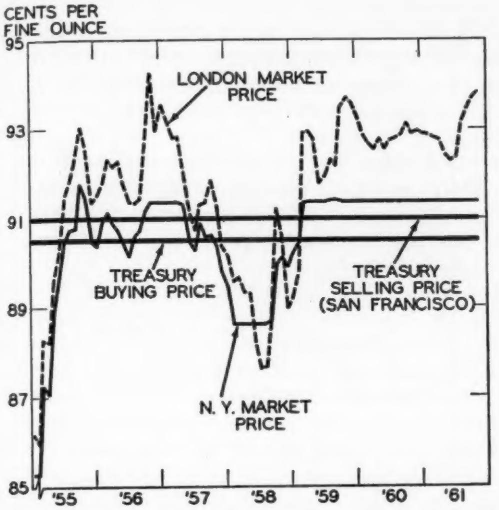
The decision to discontinue sales was precipitated by threatened exhaustion of Treasury holdings of so-called free silver. U.S. silver stocks on June 30, 1959 exceeded 3.4 billion fine ounces, the greatest aggregation of the white metal ever accumulated by any nation. However, all but 212 million ounces of this silver was tied up in coinage or as collateral behind silver certificates, which constitute about 7 per cent of our total paper currency circulation. Since June 1959, Treasury holdings of free silver have dropped from 212 million ounces to 22 million ounces.

Treasury free silver has not been going out in exports; it has been absorbed by constant growth in our silver currency circulation and sales for use here in the arts and industry. The discontinuance of Treasury sales theoretically could lead to an advance in price to $1.29 per fine ounce, the point at which redemption of silver certificates would be the cheapest way for users to get the metal.

The potentiality of retirement of silver certificates would put an automatic ceiling on the price of the metal for a long time to come. Few practical observers expect that the price of silver will rise to anything like $1.29, particularly since the Treasury will take care of its requirements for subsidiary silver coinage by retiring silver certificates. In the view of Mr. Simon D. Strauss of the American Smelting and Refining Company, as reported in the November issue of the *Engineering & Mining Journal*, a price of $1.10 would bring out quantities of hoarded silver and stimulate exploration and new production.

### *Historical Background*

The silver problem today cannot be fully understood without recalling a few salient facts




**U.S. Treasury and Open Market Silver Prices, 1955-61**

(Monthly Averages)

Note: The New York price is that quoted by Handy & Harman for silver in unrefined materials; it is usually ¼ cent below the refined silver price. November plottings are the average for November 1-28.

of monetary history. The original dollar was a silver dollar, though the emerging importance of gold led Congress, on the recommendation of Alexander Hamilton, to establish in 1792 a bimetallic gold and silver standard. This failed to work, because the relative values of the two metals did not stand still, and gold emerged as the dominant monetary base with silver playing a subsidiary role. The pound sterling, once a pound of silver, became the leading currency of the world after the Napoleonic wars as a gold sovereign. Other nations, save China, generally and gradually shifted to a gold or gold-exchange standard.

The decline of silver was powerfully resisted in the United States which, from about 1871 to 1900, was the world's biggest producer of the metal and also had a large agricultural population that attributed falling commodity prices to shortages of money. Since 1873, when the United States formally abandoned bimetallism, Congress at various times has passed laws requiring the Treasury to purchase silver not only for use in subsidiary coinage but also as backing for paper silver certificates. The United States has thus accumulated a hoard of some 1.8 billion ounces of silver to implement the rights of holders of $2 billion-odd silver certificates to redeem them.

The silver purchase laws in force are the Silver Purchase Acts of 1934 and 1946. A Presidential proclamation in December 1933, when the New York market price was 44 cents, prescribed that the Treasury should pay 64.64 cents per fine ounce for domestically mined silver. After several changes made by Presidential proclamations, the buying price became fixed by legislation—in 1939 at 71.11 cents and in 1946 at 90.5 cents, the level presently prevailing. Silver purchases were also conducted abroad, but abandoned in 1942 after they disrupted the world market and forced China off the silver standard.

Between 1942 and 1959, apart from Lend-Lease transactions in silver, U.S. silver stocks were further enlarged out of domestic production. The arts and industry, for the most part, could satisfy their needs from cheaper sources abroad. Since 1959 the world price has been above the Treasury's 90.5 cent buying price, with the result that the Treasury has been getting little silver.

While earlier silver legislation had particularly in mind assistance to producers and increase of money supply, the Silver Purchase Act of 1946 took account of the problems of silver users and authorized Treasury sales. The selling price, until discontinued on November 29, was 91 cents per ounce at the San Francisco mint and somewhat higher in Denver and New York. Treasury selling, restricted to domestic users, held down the open market price in New York —quoted since 1959 at 91⅜ cents by Handy & Harman, leading fabricators of gold and silver in the United States. In London, which is now the principal free market for silver as well as for gold, the price over the past two years has been ranging between 92 and 94 cents. The higher London price, explained by enlarged demand for silver abroad, has been diverting supplies which used to go to the American market.

### *110 Million Ounce Annual Deficiency*

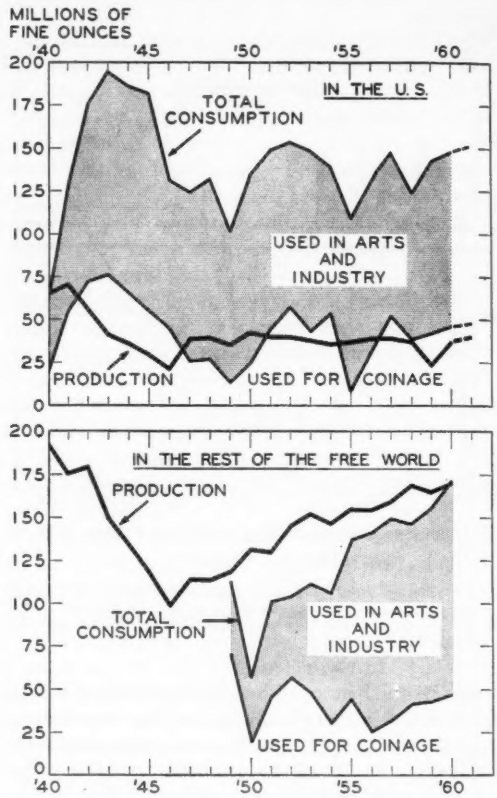
Most silver production is concentrated in North America. In the twentieth century the United States has been displaced by Mexico as the world's largest producer; Canada holds third place. As the top section of the next chart shows, silver production in the United States—except in 1959 when output was depressed by strikes—has held near a level of 40 million fine ounces a year. Silver coinage alone has been taking somewhat more than this amount in recent years. With net usage in industry and the arts upwards of 100 million ounces a year, the U.S. silver deficiency has exceeded 110 million ounces annually since 1959. Although complete figures are lacking for a full accounting of supplies and uses, the following table shows the changing picture.

**Silver in the United States**

(In Millions of Fine Ounces)

| | 1957 | 1958 | 1959 | 1960 | 1961 |
|---|---|---|---|---|---|
| **Output** .......... | 38.7 | 36.8 | 23.0 | 36.8 | 40.0† |
| **Uses** | | | | | |
| Industry and arts | 95.4 | 85.5 | 101.0 | 102.0 | 104.0† |
| Coinage ........ | 52.0 | 38.2 | 41.4 | 46.0 | 48.0† |
| Total .......... | 147.4 | 123.7 | 142.4 | 148.0 | 152.0† |
| Excess of uses over output ..... | 108.7 | 86.9 | 119.4 | 111.2 | 112.0† |
| **Imports** | | | | | |
| Commercial .... | 116.3 | 62.6 | 24.1 | 45.0 | 35.9‡ |
| Lend-Lease returns ........ | 89.8 | 103.4 | 45.0 | 15.7 | n.a. |
| **Exports** .......... | 10.3 | 2.7 | 9.2 | 26.6 | 28.5‡ |
| Excess of commercial imports over exports ... | 106.0 | 59.9 | 14.9 | 18.4 | 7.4‡ |
| **Changes in U.S. Treasury's stocks:** | | | | | |
| "Free" stocks.. | +40.0 | +74.8 | —27.1 | —51.6 | —91.1§ |
| Other stocks*.. | — 6.7 | +17.5 | —19.3 | —16.0 | —16.9§ |
| **Total change** .. | +33.3 | +92.3 | —46.4 | —67.6 | —108.0§ |

* Stocks securing silver certificates, and silver coin in the hands of the Treasury. † Tentative estimates. ‡ Through September 1961. § Through November 21, 1961. n.a.—not available.
Sources: U.S. Bureau of Mines, U.S. Department of Commerce, and U.S. Treasury.




**Silver Output and Uses, 1940-61**

The deficiency of U.S. production has been covered by imports, including returns of silver lent to the United Kingdom, the Netherlands, India, Pakistan, and certain other countries during World War II under Lend-Lease legislation. But returns of Lend-Lease silver have dried up and regular commercial imports have been falling off with the rise in silver usage abroad.

The lower section of the chart gives a picture of production and consumption of the metal in the rest of the free world. According to estimates by Handy & Harman, consumption has reached the level of production, about 170 million fine ounces a year. Usage in the arts and industry abroad now takes three quarters of the new production. The United Kingdom, India, and Pakistan withdrew silver coins from circulation as a means of facilitating return of metal obtained under Lend-Lease during the War, thus adding to world silver supplies. But new silver coinage programs in France and Italy are currently adding to needs for monetary silver abroad.

Thus, on the basis of figures for the past two years, the American shortage of some 110 million ounces is also a measure of Free World shortage. Offerings from Red China, for balance-of-payments reasons, have been reported in the press as likely to reach 40 million ounces in 1961. These, believed to come from stocks of coins surrendered to the government, have been supplementing supplies in Western Europe.

The natural effect of the silver shortage has been to firm up world prices and this tendency is strengthened now that the U.S. Treasury has dropped out as a seller. A rise in the price will stimulate production though it must be borne in mind that most of the world's silver is produced from ores bearing copper, lead, zinc, and gold. Thus, prices of other metals have influences on silver production. There is, however, no doubt that a sustained advance in the price of the metal could produce a sizable increase in supply by stimulating exploration and new production as well as by inducing a melting down of silver coins—the kind of automatic demonetization that has occurred so often over the world's history when hard money has become worth more as metal than as money.

### *3.3 Billion Ounce U.S. Stocks*

Along with gold, silver coins and objects of art are often held in many parts of the world as stores of value. No one can say for sure what the aggregate amount might be or how much would be turned back into metal at any given price level. But it is possible to measure U.S. silver stocks in forms of coins, reserves against silver certificates, and Treasury free silver. As brought out in the next chart, these stocks aggregate more than 3.3 billion fine ounces, an amount

that dwarfs the calculated annual shortage of 110 million ounces a year. Of this stock, about 1.2 billion ounces represent the content of subsidiary silver coins—dimes, quarters, and half dollars. These would not be worth more as silver than as money unless the price of the metal rose above $1.38 per fine ounce. There is a somewhat limited circulation of standard silver dollars, which, technically, would be worth their weight in silver content if the price rose to $1.29. But the bulk of the U.S. silver stock consists of bars or bullion held in reserve for redemption of silver certificates. Since silver certificates are payable to the bearer on demand in silver, this silver bullion could be drawn upon and presumably would be if the price of the metal got up much beyond $1.29.

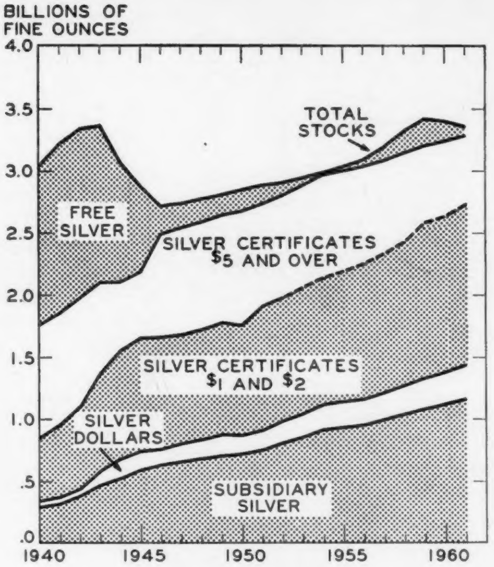
The simplest way for the Treasury to save on silver is gradually to withdraw silver certificates, freeing silver bullion for use in subsidiary coinage. Under present law, certificates in denominations of $5 and higher can be replaced in circulation by Federal Reserve notes. Further huge amounts of silver are tied up behind $1 bills. These can be replaced by Federal Reserve notes if Congress accepts the President's recommendation and authorizes the Federal Reserve Banks to issue notes in the $1 denomination.

With all our silver treasure, there is no need to follow the example of some other countries which have totally demonetized silver and swung over to cheaper metals for all coins. We can afford to keep silver in subsidiary coinage.

### *Time to Restore a Free Market*

It is clear, from the most competent estimates available, that the world's silver production can be fully absorbed by industry and the arts. It should be clear, also, that satisfaction of these growing needs should have a prior claim on new supplies. Gold has the primary function of serving as a reserve behind currencies. Silver, long ago displaced from this position, has earned a critically important place as an industrial commodity, with its rare properties of noncorrosiveness and conductivity. People may not realize that they are consuming silver, in nitrate form, when they take pictures. Applications in electricity, electronics, and missiles are essential and growing.

Silver purchase legislation in the United States has had purposes of enlarging the money supply and raising prices for the benefit of producers. Whatever could be said for the programs in generations past, they are assuredly inappropriate in a world that wants price stability rather than price inflation. The opportune moment arrived when, with a minimum impact on silver prices, the Treasury was able to drop out and let the free market do the job of equating supply and demand.




**U.S. Silver Stocks, 1940-61**

Note: Excluding silver contained in five-cent coins minted during World War II, estimated at about 49 million ounces.

Bills have been repeatedly introduced in Congress—though never before with the endorsement of the Administration—to repeal the existing silver purchase legislation, including the special 50 per cent tax on profits from market transactions in silver imposed under the Silver Purchase Act of 1934 to discourage speculation in the metal. This tax, which has never brought in any significant revenue, will have to be abolished if we want to have a market for silver comparable in efficiency to those for other commodities.

As Mr. F. H. Wemple, Treasurer of Handy & Harman, noted in a recent address:

> It is, of course, quite natural that consumers want lower prices while producers want higher prices for silver. This is true of all commodities, not just silver. The best place to resolve these differences of opinion is the market place, not the government. We have seen again and again in the past the unhappy results of government interference into the workings of commodity markets. Policies undertaken in an effort to aid one segment of our economy are usually damaging to other segments, and frequently fail to provide lasting help to those for whose benefit they are designed.
>
> I have read in the press and have been told directly that many producer interests are in favor of a free market for silver. We also advocate a free market. Therefore, it seems to me that it is time for all of us to cast our vote for a truly free market for silver. . . .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